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IN THE

# Supreme Court of the United States

October Term 1948
No. 645

UNIVERSAL ATLAS CEMENT COMPANY,
*Petitioner,*

*v.*

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

A. CHAUNCEY NEWLIN,
*Counsel for Petitioner.*



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COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered December 17, 1948 (R. 73a).

### Opinions Below

The opinion of the Tax Court (R. 42a) is reported in 9 T. C. 971. The opinion of the Court of Appeals (R. 72a) is reported in 171 F. (2d) 294.

### Jurisdiction

The judgment of the Court of Appeals was entered on December 17, 1948 (R. 73a). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 935.

## Question Presented

The question presented is whether for Federal income tax purposes petitioner in calculating its taxable net income for 1939 is entitled to deduct from its gross income a payment of $100,000 made by it in that year to the State of Texas. The payment was made in connection with the settlement before trial of a civil suit brought by the State against the petitioner and others for alleged violations of the Texas anti-trust laws. Under the terms of the settlement it was expressly stipulated that the settlement did not indicate in any degree an admission of truth or correctness of the allegations of the State.

## Statutes and Regulations Involved

*Internal Revenue Code:*

"Sec. 23. Deductions From Gross Income.

"In computing net income there shall be allowed as deductions:

"(a) *Expenses.*—

"(1) *Trade or Business Expenses.*—

"(A) *In General.* — All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *."

*Regulations 111*:

"Sec. 29.23(a)-1. *Business Expenses.* — Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or per-

taining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23(b) to 23(z), inclusive, and the regulations thereunder. * * * "

## Statement

The taxpayer manufactures and sells cement in various parts of the United States, including Texas (R. 43a). In 1938 the State of Texas filed suit against it and five other companies alleging they had entered into a conspiracy to violate anti-trust laws of the State. In accordance with its statutes the State sought to impose penalties of from $50 to $1,500 per day from January 13, 1930 to the time of filing the petition, to impose a lien for such penalties on all of the properties of the defendants, to cancel the permits of the defendants to do business in Texas, to have a receiver appointed, and for an injunction prohibiting the defendants from continuing to do the alleged acts and practices which were alleged to constitute violations of its anti-trust laws (R. 43a, 44a).

A series of hearings in the nature of pre-trial examinations were held over a period of six months in Austin, Los Angeles, New York and Chicago (R. 44a). At these hearings no part of the defendants' case was put in evidence (R. 46a).

Before trial the taxpayer learned there was a possibility of settling the case (R. 17a). Negotiations ensued and on October 4, 1939 a settlement agreement was executed (R. 53a). The agreement provided that the State should recover from the defendants "jointly and severally, the sum of Four Hundred Thousand ($400,000.00) Dollars in full

satisfaction of all claims of the State of Texas for penalties for the alleged violations of law set out in plaintiff's first amended original petition and in full satisfaction of all expenses of the Attorney General in investigating, instituting and preparing this cause for trial" (R. 55a); that all costs should be adjudged against the defendants, and that the defendants should all be temporarily enjoined from doing certain specified acts in connection with the manufacturing, marketing and sale of cement in Texas (R. 55a-65a, 44a, 45a).

Section VII of the settlement agreement also provided:

> "This agreement is made by the parties hereto solely and only for the purpose of compromising and settling the matters involved in this suit, by and between the State of Texas, as plaintiff, and the defendants herein named, and it is expressly understood and agreed as a condition hereof, that neither this agreement nor the judgment to be entered thereon, nor any clause or provision of said agreement or judgment, shall constitute or be construed to be an admission or estoppel as against the various defendants herein as evidencing or indicating in any degree an admission of truth or correctness of the allegations in plaintiff's petitions contained in whole or in part." (R. 66a, 67a.)

In the portion of the agreement where the taxpayer agreed to the issuance of an injunction against acts of conspiracy in restraint of trade it was provided:

> "The defendants severally deny that said practices are the result of any agreement, express or implied, or are followed for any unlawful purpose." (R. 60a.)

On the same day a decree was entered which incorporated the settlement agreement, approved it, and, in accordance with it, provided for the recovery by the State of Texas of $400,000 and costs from the defendants and for an injunction (R. 13a, 14a, 46a).

Pursuant to the decree the taxpayer, on October 5, 1939, paid to the State of Texas $100,000 as its share of the sum of $400,000 provided for in the decree (R. 46a).

At the time of entering into the settlement agreement the taxpayer had incurred expenses of $66,000 in preparation for the coming litigation, and was informed by its counsel that an additional expense in excess of $100,000 would be incurred in the litigation and that the further preparation for the trial and the litigation itself would consume considerable additional time (R. 46a).

The taxpayer entered into the settlement agreement and paid the $100,000 because the terms of the agreement were not such as materially to interfere with its business (R. 20a, 21a, 24a, 25a), and it was concluded that, regardless of the outcome, it was more economical to pay this amount than to continue the litigation (R. 20a-24a, 29a, 39a, 46a).

In its Federal income tax return for 1939 the taxpayer took the $100,000 as a deduction. The Commissioner disallowed the deduction and the Tax Court, two judges dissenting (R. 49a), upheld the Commissioner. The Tax Court's decision was affirmed by the Court of Appeals for the Second Circuit, per curiam, on the authority of *Commissioner* v. *Longhorn Portland Cement Company*, (C. A. 5, 1945) 148 F. (2d) 276, cert. den., 326 U. S. 728[1] (R. 72a).

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[1] In the *Longhorn* case the Tax Court allowed the deduction (3 T. C. 310) and the Fifth Circuit reversed.

## Specification of Error to be Urged

The Court of Appeals erred in holding that petitioner was not entitled to deduct the payment of $100,000 as an ordinary and necessary business expense, under Section 23(a)(1)(A), I. R. C.

## Reasons for Granting the Writ

*The decision of the Court of Appeals is in conflict with applicable decisions of this Court.*

The payment by petitioner to the State of Texas was an ordinary and necessary business expense within the meaning of Section 23(a)(1)(A), I. R. C. as interpreted by this Court. *Commissioner* v. *Heininger,* 320 U. S. 467; *Welch* v. *Helvering,* 290 U. S. 111; *Kornhauser* v. *United States,* 276 U. S. 145.

The following paraphrase from the opinion of this Court in the *Heininger* case, *supra,* p. 472, demonstrates that under the reasoning there this payment should be considered an ordinary and necessary business expense:

> "Upon being served with notice" in the Texas anti-trust action the taxpayer "was placed in a position in which not only its selling methods but also the continued existence of its lawful business" in the State of Texas "were threatened with complete destruction." It "appears from the record" that the taxpayer did not believe, "nor under our system of jurisprudence was it bound to believe," that a decree destroying its business in Texas "was justified by the facts or the law. Therefore, it did not voluntarily abandon the business but defended it by all available legal means. To say that this course

> of conduct and the expenses" which it involved in bringing the proceeding to a conclusion on a basis satisfactory to the taxpayer "were extraordinary or unnecessary would be to ignore the ways of conduct and the forms of speech prevailing in the business world."

In the *Heininger* case it was held that costs which qualify as ordinary and necessary business expenses within the commonly accepted meaning of those terms are deductible unless only the deduction would "frustrate sharply defined national or state policies proscribing particular types of conduct" (pp. 473, 474).

There, 39 U. S. C., §§259 and 732, authorizing the Postmaster General to issue fraud orders, were involved. The Court concluded that if the deduction there claimed was to be disallowed "it must be because allowance of the deduction would frustrate the sharply defined policies" of those statutes (p. 474). Here, the settlement concerned an alleged violation of the anti-trust laws of Texas. Therefore, under this Court's decision in the *Heininger* case the deduction here in question can be properly disallowed only if it is concluded that its allowance would frustrate sharply defined policies of the Texas anti-trust laws. But here the State conceded that no violation of its anti-trust laws had been established (R. 66a, 67a). As the Tax Court said in its opinion in *Longhorn Portland Cement Co.*, 3 T. C. 310, 318:

> "The state is in no position under the judgment entered to say that petitioners were convicted of any violations of its anti-trust statute. The judgment which the state agreed should be entered specifically refutes conviction or admission of violations in whole or in part."

The taxpayer did not pay part of the penalty claimed. It simply paid a sum of money. Faced with the prospect of serious disruption of its business in continuing a protracted trial, adverse publicity, and even greater expense of further litigation, the taxpayer recognized that it was simply a matter of good business to pay something to terminate the litigation, even though it believed it owed nothing. And the State accepted the money while expressly admitting at the same time that the payment was not an admission of the truth of its accusations, and therefore admitting that no case had been made for the proposition that a penalty payment in any amount was due. Guilt is never presumed, and the decree expressly refrained from making a finding of guilt. Consequently, there could be no judgment for penalties. And the decree did not provide for the satisfaction of penalties; it simply released the defendants from any "*claims*" for penalties (R. 55a). This was not a compromise payment of penalties admittedly due or found to be due.

Since the record does not justify a finding that the State inflicted punishment for violation of its anti-trust laws there can be no question about possible frustration of the public policy of the State as reflected by those laws. It would be unrealistic to consider that mitigation of the burden of the payment by its allowance as a Federal income tax deduction would frustrate sharply defined public policy of the State of Texas as reflected in its anti-trust laws *when the State agreed it had not been found that such laws had been violated.*

Under such circumstances there is no more reason to conclude that allowance of deduction here would violate

Texas anti-trust laws than it was to conclude that the costs in the *Heininger* case would frustrate the policies of the statutes there involved.

We, therefore, respectfully submit that the decision below is in direct conflict with the principles established in the *Heininger* case.

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*The decision of the Court of Appeals involves an important question of Federal law which has not been but should be settled by this Court.*

As this Court found in the *Heininger* case, in the administration of the Federal income tax laws the question repeatedly arises whether a particular expenditure, which under the generally accepted meaning of those terms would be considered an ordinary and necessary business expense, should be disallowed as a deduction in order that "tax deduction consequences might not frustrate sharply defined national or state policies proscribing particular types of conduct" (p. 473). By observing in its opinion there that disallowance on this ground of a deduction otherwise within the statute attaches an additional "serious punitive consequence" (p. 474) to the alleged violation of law, it is assumed this Court was indicating that deductions should not be lightly disallowed on such vague grounds of public policy.

The scope of the doctrine never has been well defined and the absence of critical analysis has led to a hodge-podge of decisions and an unsatisfactory condition of the law. See 54 Harvard Law Review 852. It is currently a question

of considerable general interest. To mention only a few of the more recent cases, note *Jerry Rossman Corp.*, 10 T. C. 468 (particularly the numerous dissenting opinions); *Scioto Provision Co.*, 9 T. C. 439; *Garibaldi & Cuneo*, 2 T. C. 466; *Excelsior Baking Co.* v. *U. S.*, (D. C., Minn.) decided January 13, 1949; cf. *Lela Sullenger*, 11 T. C. #127. See also *Commissioner* v. *Heide*, (C. A. 2) 165 F. (2d) 699, and *Commissioner* v. *Josephs*, (C. A. 8) 168 F. (2d) 233, cert. den., 93 L. Ed. 94 (remanded to Tax Court).

A review by this Court of the present case could well serve to clarify the existing confusion.

In its opinion in the *Heininger* case this Court said:

> "Where a taxpayer has violated a federal or state statute and incurs a fine or penalty he has not been permitted a tax deduction for its payment." (p. 473)

Assuming *arguendo* that thereby this Court approved the line of decisions to which it there referred, that is not this case. Here, there was no determination that the taxpayer had violated the statute in question (see p. 8, *supra*). The State of Texas agreed that the settlement should not be considered an admission of the alleged violation (R. 45a).

Such circumstances serve well to raise the question of the weight to be given public policy considerations in overcoming contrary import of statutory language, and the question of the length to which courts should go in converting a legislatively imposed tax on net income into a judicially imposed tax on gross receipts.

These are unsettled questions of broad general importance which are raised by the present case, and we respectfully submit they abundantly warrant a review by this Court of the decision below.

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*The decision below puts a premium on continuing anti-trust litigation and a penalty on settlements.*

As held in the *Heininger* case, a taxpayer may deduct the expenses of defending against a civil action for an alleged violation of a statute in the course of conducting a legitimate business. If a payment made in settlement of such an action, without admission of guilt, is not deductible but the expenses of further contest are deductible, an inducement to settle is removed and an inducement to continue litigation is created.

We submit it is a bad policy thus to discourage settlements, and it is contrary to principles which this Court has enunciated. As observed in *Williams* v. *First National Bank,* 216 U. S. 582, 595, "compromises of disputed claims are favored by the courts." And this is true "as well where the government is a party as where the litigation is solely between private individuals" (*United States* v. *Knabe,* 147 Fed. 802, 806), since "an end of litigation is considered good for the public weal" (*Greene Motor Co.,* 5 T. C. 314, 320).

We submit a decision which encourages continued litigation of anti-trust suits and discourages compromise settlements is a decision which amply justifies consideration by this Court.

## Conclusion

For the foregoing reasons this petition should be granted.

Respectfully submitted,

A. CHAUNCEY NEWLIN,
*Counsel for Petitioner.*

March 1949.

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# In the Supreme Court of the United States

OCTOBER TERM, 1948

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No. 645

UNIVERSAL ATLAS CEMENT COMPANY, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

---

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT*

---

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 42-49) [1] is reported in 9 T.C. 971. The *per curiam* opinion of the Court of Appeals (R. 72) is reported in 171 F. 2d 294.

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[1] The record references are to the Petitioner's Appendix, the Respondent's Appendix and the Proceedings in the Court of Appeals for the Second Circuit unless otherwise indicated. A duplicate certified copy of the Transcript of Record has been filed with the Clerk of this Court.

JURISDICTION

The judgment of the Court of Appeals was entered on December 17, 1948. (R. 72-73.) The petition for a writ of certiorari was filed on March 15, 1949. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the sum of $100,000 paid by the taxpayer in 1939 in compromise of an anti-trust suit brought against it by the State of Texas was deductible from gross income as an "ordinary and necessary" business expense within the meaning of Section 23 (a)(1)(A) of the Internal Revenue Code, as amended.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Section 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798][2]

*Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *

* * * * *

[2] This amendment was made applicable to taxable years beginning after December 31, 1938, by Section 121 (d) of the Revenue Act of 1942.

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.23 (a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23 (b) to 23 (s), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. * * *. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. * * *.

## STATEMENT

The stipulation of facts (R. 9-11) and the exhibits attached to it were adopted by the Tax Court (R. 43). The facts as found by the Tax Court (R. 43-46) may be summarized as follows:

Prior to and during 1939, the taxable year, the taxpayer was engaged in the business of manufacturing and selling cement in various parts of the United States, including Texas. On March 7, 1938, the State of Texas filed a suit against the taxpayer and five other companies (including Longhorn Portland Cement Company), alleging that they had entered into a conspiracy to violate the anti-trust laws of the State of Texas and had

committed various acts in connection with the conspiracy, and praying for penalties, forfeitures, etc., as provided by Articles 7426 through 7447, 20 Vernon's Texas Civil Statutes Annotated (1925). (R. 43.) Later the State of Texas filed an amended petition against the taxpayer and those other corporations incorporated outside the State of Texas which charged the defendants with conspiracy in various ways to restrain trade, to fix the price of cement and to prevent and lessen competition. (R. 43-44.)[3] The petition sought to impose penalties of from $50 to $1,500 per day from 1930 until 1938, to impose a lien for the penalties on all of the properties of the defendants, to cancel the permits of the defendants to do business in Texas, to have a receiver appointed, and for an injunction. (R. 44.)

After a series of hearings in the nature of pretrial examinations had been held over a period of six months, a settlement agreement was entered into whereby the four defendants, including the taxpayer, paid $400,000 in full satisfaction of all claims for penalties. (R. 44.) The Court entered its decree,[4] pursuant to which the taxpayer paid the State of Texas $100,000 as its share of the $400,000, provided for in the agreement. The taxpayer deducted the sum so paid on its federal in-

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[3] The taxpayer in this case was also a defendant in proceedings brought by the Federal Trade Commission. See *Trade Comm'n* v. *Cement Institute*, 333 U. S. 683.

[4] The final decree, including the settlement agreement, constitutes Exhibit E, attached to the Stipulation of Facts. (R. 52-70.)

come tax return for 1939, but the Commissioner disallowed the deduction. (R. 46.) The Tax Court, with two judges dissenting, upheld the Commissioner (R. 49), and the court below, in a *per curiam* opinion, affirmed the decision of the Tax Court (R. 72).

ARGUMENT

1. This case is substantially identical with *Commissioner* v. *Longhorn Portland Cem. Co.*, 148 F. 2d 276 (C.A. 5), in which this Court denied certiorari, 326 U. S. 728. There is no more reason for further review in this case. The Longhorn Company was one of the defendants in the original action brought against the taxpayer in this case. (R. 9, 43.) Subsequently, a separate action was brought by the State of Texas against the Longhorn Company and another corporation, both of which were incorporated in Texas, for violation of the anti-trust laws, in which the State sought to recover statutory penalties and other affirmative relief. Each corporation paid the State in 1939 the sum of $50,000 in compromise of the suit, and an agreed judgment was entered, just as in this case, which recited that the payments were in full satisfaction of all claims of the State for penalties for the alleged violations of law, but that the defendants did not thereby admit, or estop themselves to deny, the truth of the allegations of the petition. The corporations sought to deduct the sums in question as ordinary and necessary business expenses and the Tax Court permitted them to take the deductions on the ground that the compromise payments were not

penal in nature. On appeal, the Fifth Circuit reversed the decision of the Tax Court and held that the sums in question were paid as penalties and therefore were not deductible.

The court below affirmed the decision of the Tax Court in the present case on the authority of the *Longhorn Portland Cem. Co.* case. (R. 72.) See also *Helvering* v. *Superior Wines & Liquors,* 134 F. 2d 373 (C.A. 8th); *United States* v. *Jaffray,* 97 F. 2d 488 (C.A. 8th), affirmed on other grounds, 306 U. S. 276; *Standard Oil Co.* v. *Commissioner,* 129 F. 2d 363 (C.A. 7th), certiorari denied, 317 U. S. 688; Treasury Regulations 103, Sec. 19.23 (a)-1, *supra.*[5]

In *Commissioner* v. *Heininger,* 320 U. S. 467, involving the deduction of attorney's fees in a Post Office fraud order case, this Court said (p. 473):

> Where a taxpayer has violated a federal or a state statute and incurred a fine or penalty he has not been permitted a tax deduction for its payment.

An action under the Texas anti-trust act has been held penal in nature. See *Waters-Pierce Oil Co.* v. *State of Texas,* 48 Tex. Civ. App. 162, 181, writ

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[5] Compare *Commissioner* v. *Heide,* 165 F. 2d 699 (C.A. 2d), and *Commissioner* v. *Josephs,* 168 F. 2d 233 (C.A. 8th), certiorari denied, 335 U. S. 871, in both of which cases an amount paid in compromise of a civil suit based on negligence was not allowed as a deduction as an ordinary and necessary expense under Section 23 (a) (2) of the Internal Revenue Code, dealing with non-business expenses.

of error refused, 103 Tex. 676, affirmed, 212 U. S. 86. While there was a compromise in the present case, the decree expressly states that the sum in question was paid in full satisfaction of all penalties for alleged violations of the Texas statute. (R. 69.) The compromise, therefore, has the same effect as though there had been a conviction after a trial upon the merits. *United States* v. *Chouteau*, 102 U. S. 603, 611.

The petition for certiorari describes at length the motives which led the taxpayer to compromise the suit by the State of Texas for violation of its anti-trust laws. (Pet. 6-8.) But the motives of the taxpayer are unimportant in a case of this kind; the only question is whether the amount paid in compromise was a penalty, or resembles a penalty so closely that it should be treated as one. Although the settlement agreement recites that it was not an admission by the taxpayer of guilt (R. 66-67), the judgment speaks for itself.

The taxpayer argues that the decision of the court below puts a premium on continuing anti-trust litigation. (Pet. 11.) But if the taxpayer had continued to contest the suit and had then been found guilty, the penalties might have amounted to $200,000 or $300,000 instead of $100,000. A defendant in an anti-trust case may find it profitable to compromise, regardless of tax effect. It may be pointed out that the taxpayer here was allowed to deduct the expenses of the litigation, just as the

taxpayer in *Commissioner* v. *Heininger,* 320 U. S. 467, was allowed to deduct them; it is only a penalty that may not be deducted.

2. There is no conflict of decisions. While the taxpayer alleges that the decision of the court below is in conflict with the decisions of this Court in *Commissioner* v. *Heininger, supra; Welch* v. *Helvering,* 290 U. S. 111; and *Kornhauser* v. *United States,* 276 U. S. 145 (Pet. 6), none of these cases involved the deduction of penalties or amounts paid in compromise of a suit for penalties.

## CONCLUSION

The decision of the court below is correct. There is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
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THERON LAMAR CAUDLE,
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*Special Assistants to the Attorney General.*

APRIL, 1949.

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